

## Chapter 3 **Cost of Government Services Guide**

### Chapter 3, Section 1

#### About this chapter

##### 3.1.1 What is the purpose of this chapter?

###### **A guide to calculating the cost of government services**

RCW 41.06.142 permits agencies to purchase services from the source they find to be the most cost effective and efficient. Key to making this determination is the ability to make an accurate and fair comparison of the current costs to provide the service within the agency against the proposed costs of employee business units (EBUs) and / or with outside contractors. This chapter provides guidelines and schedules for calculating the cost of government services for competitive contracting evaluations.

The underlying authority for this chapter is found in RCW 41.06.142, RCW 43.19 and WAC 236-51.

***Note: The Competitive Contracting Evaluation Model is an Excel ® workbook available on-line containing the four worksheets referenced in this chapter. A screen shot example can be found in Appendix A of this chapter. The worksheets are: Schedule A - Evaluation Summary, Schedule B - Contracting Cost Comparison, Schedule C-1 Current Service Delivery, and Schedule C-2 Employee Business Unit Bid.***

###### **This chapter assumes some knowledge of state accounting and budgeting practices**

Individuals developing the cost of government service analysis are the intended audience for this guide. This guide assumes that the person conducting the analysis has some familiarity with state accounting and budgeting terms and practices.

This guide can be used for different purposes. While this guide is written with a focus on the development of cost information an EBU needs to provide for the competitive contracting Evaluation Model (see Section 3.2.1), agencies may also find it useful in thinking through the potential benefits of competitive contracting a service in the first place. The same steps to service definition and cost identification could be used for both analyses.

##### 3.1.2 What are the initial steps of the process?

###### **Where in the competitive contracting process does the cost of government service guide play a role? *(highlighted in italics)***

###### ***Prior to notification and solicitation the agency:***

- Identifies and defines a candidate service for competitive contracting (see chapter 1)
- *Conducts a cost of government service analysis to determine the current service delivery costs(Schedule C-1) that will be used by the agency to compare with proposals submitted by bidders responding to the competitive contracting solicitation (see chapter 3)*
- Conducts a business requirements analysis (see chapter 2)
- Develops a Performance Work Statement (PWS) and Quality Assurance Plan (QAP) (see chapter 2)

- *Verifies that preliminary requirements outline by RCW 41.06.142 have been met (Schedule A (first half))*
- Provides notice to potentially displaced employees that within 90 calendar days (or greater) it plans to issue a competitive contracting solicitation (see chapter 5)

#### ***Post notification and solicitation***

- If potentially displaced employee alternatives are rejected or none are offered within 60 calendar days, the agency proceeds with its solicitation (see chapter 5)
- Potentially displaced employees decide to form one or more EBUs to compete as a bidder in the solicitation (see chapter 5)
- *An EBU prepares its cost proposal (Schedule C-2) (see chapter 3)*
- *The agency then compares the results from the cost of government service analysis (current state) against proposals submitted by bidders to help determine award (Schedules A (second half) & B) (see chapter 3)*

**Note:** *For the purposes of brevity, the list above does not reflect additional requirements that apply to potentially displaced employees in a bargaining unit. For the purposes of this illustration though, the role of the cost of government services guide is the same regardless.*

### **3.1.3 What are the preliminary requirements?**

#### **Schedule A, Section I: Preliminary Requirements Checklist**

RCW 41.06.142 outlines certain requirements in the process for competitive contracting. Section I of the Evaluation Summary form (Schedule A) asks the agency to confirm that these preliminary requirements were completed. They are provided in the schedule as an additional tool for agencies to use. More comprehensive guidance on how to identify and evaluate candidate services, develop business requirements, and assess readiness can be found in Chapters 1, 2, 4, and 8 respectively.

The Preliminary Requirements Checklist on Schedule A conveniently documents that the preliminary criteria were met. If the answer to any of the questions except “B” (which relates to agency management criteria) is “no”, then the agency can not proceed with competitive contracting.

**Important note:** *Agencies must ensure that any staff assisting the EBU in developing Schedule C-2 (i.e. their bid) cannot be involved in the procurement process (see WAC 236-51-302 and WAC 236-51-410). Agencies should retain documentation of the following, at a minimum, in accordance with their record retention schedules:*

- *All required notifications - content and dates*
- *Employee alternatives received and dates received*
- *Evaluation of alternatives*

### **3.1.4 Defining the service**

To achieve a fair and successful outcome through competitive contracting, it is critical for the agency to carefully define the service scope, volume, and performance requirements via a Performance Work Statement (PWS) and Quality Assurance Plan (QAP) (see Chap-

ter 2). When the agency decides to competitively contract a service, it will create solicitation documents consistent with the requirements of WAC 236-51-305. In this chapter we will refer to solicitation documents in the collective as the Invitation for Bid (IFB) or Requests for Proposal (RFP).

### **3.1.5 Identifying costs**

The agency must then identify their costs to provide the specific level of service outlined in the RFP. Cost requirements are outlined in WAC 236-51-215. The projected department costs may be based on its existing costs (where available) and its estimated costs based on re-engineering results or budget estimates for services not currently provided by state staff.

RCW 41.06.142 requires the state to use the “avoidable cost” method for cost comparison, where a contractor bid or external cost estimate is compared to the internal costs the state would not incur if the service was contracted. These avoidable costs include all direct costs, as well as any portions of indirect overhead or short-term fixed costs that can be eliminated over the life of a service contract. Using avoidable costs ensures that a decision to outsource does not result in an increase in the overall cost of providing a service, as the state will incur certain costs (“unavoidable”) even if the service is contracted. Within this chapter:

**Section 3.3:** Offers guidance on identifying the direct costs of services.

**Section 3.4:** Discusses indirect overhead costs.

**Section 3.5:** Provides information on cost allocation approaches.

### **3.1.6 Determining an agency’s costs associated with competitive contracting**

The last component of the analysis is adjusting external contractor costs by the amount of one-time transition, ongoing contract administration, and other costs that would be newly incurred if the service were awarded to an outside contractor.

**Section 3.6:** Provides guidance on calculating these adjustments.

## *Chapter 3, Section 2*

### **Presentation of the Evaluation Model**

#### **3.2.1 Preparing the Evaluation Model**

##### **Introduction**

The Evaluation Model is the standard required framework for costing of a state-performed service and then comparison to the best alternative source. The overall goal of competitive contracting is to ensure that services are provided at the best value to taxpayers.

The Evaluation Model schedules (Appendix A) primarily focus on cost identification and comparison within the competitive contracting process. Cost is only part of the value equation, which also factors in service quality and the effectiveness of results. Management will make their decision based on the service value of the viable proposals (see 2.1.3). Although the comparison of quality and results is also critical to the decision process, the method of documenting that portion of the competitive contracting process is left to the discretion of each agency. This manual provides agencies with guidance in evaluating cost and non-cost factors (see chapter 6).

It is also recognized that each agency may wish to tailor the model's format to match their standard practices and this model should be adapted to the specific circumstances of each service evaluation as required. For maximum efficiency, it is recommended that the model be adapted to incorporate existing reports and sources of data whenever practical.

The Evaluation Model is designed for use in the formal bidding process between EBU and outside contractors. However, portions of the model may also be useful in the preliminary investigation stages to simply identify the cost of a service before testing the market for viable alternatives. Use of rough estimates may be appropriate in those preliminary stages. In the bidding process, it is important that the EBU bid cost is accurate and complete. However, it must be recognized that the EBU bid is a projection of future costs, which involves estimates.

While the agency may provide resources to assist to the EBU in the bidding process, the EBU determines its bid price. The EBU proposal may involve new processes for providing the service that cost less than previous methods. The agency will independently evaluate all proposals, including the EBU's.

In addition to the other chapters of the Competitive Contracting Manual, refer to the following for further guidance on the competitive contracting process and completing the Evaluation Model:

- RCW 41.06.142
- WAC 236-51
- Resources identified in section 3.7
- WAC 357-43
- Agency or state's collective bargaining agreement.

The agency may contract with the Department of General Administration to assist with all aspects of the competitive contracting process. In addition, to help state agencies determine if competitive contracting should be an option, the Department of General Administration's Office of State Procurement (OSP) has created a "convenience contract" of pre-qualified providers able to provide consulting services. These providers can assist agencies with:

- Identifying services that could be considered for competitive contracting
- Assessments of current and future data collection associated with a service
- Developing performance standards and related information
- Determining how the agency's current service matches up with the competitive market in terms of costs and overall efficiency
- Determining baseline costs for a service
- Analysis of an agency's strengths and weaknesses in providing a service that could be identified for competitive contracting
- Risk assessments and transition planning
- Developing preliminary competition and completion schedules

- Project management and technical writing
- Facilitation of stakeholders and focus groups related to competition for a service
- Presentation of reports and results

### 3.2.2 General instructions for completing the Evaluation Model

#### Description of the Evaluation Model

The Evaluation Model shall be used by agencies and EBU's to demonstrate compliance with the requirements outlined in WAC 236-51-215 and WAC 236-51-306 (reference WAC 236-51-300):

***Schedule A: Evaluation Summary*** - This form provides summary cost information from Schedules B, C-1, and C-2, as well as other key information needed to complete the Evaluation Model.

***Schedule B: Contracting Cost Comparison*** - This form identifies the full cost of competitive contracting including the contractor price(s), contract administration costs, transition costs, and other costs. It compares these total costs to the EBU's bid and the cost of keeping the current service delivery approach. Where there are significant variations in the timing of costs between the bidders and/or internal costs, management may wish to utilize the net present value technique to restate the bids to today's dollars for comparison.

***Schedule C-1: Current Service Delivery Cost Projection*** - This form projects the direct, indirect, and other related costs of the current service delivery approach. Several revisions of this form may be completed prior to a solicitation; particularly if there have been any process improvements or employee alternatives implemented. The most current service delivery cost projection should be made available to potentially displaced employees upon notification and then to all bidders who request it.

***Schedule C-2: EBU Bid Cost Projection (Proposed)*** - This form projects the direct, indirect, transition, and other costs related to service delivery by an EBU. The form along with all drafts and supporting schedules is considered a confidential bid document to be held confidential in accordance with WAC 236-51-405.

#### How to complete the Evaluation Model

The Evaluation Model is in order from summary level down to detail sheets. Generally, the cells for data input are identified with a blue font. Cells which are linked to other pages or that are calculated by formula are in a violet (or black) font.

The general information would be typed onto the first two sections of Schedule A first. Then the cost information developed on relevant supporting detail schedules would also be summarized on Schedule A. The agency may have existing reports that it may wish to incorporate as supporting schedules. While today's service costs are a good starting point, future changes to business processes/environments would have an impact on costs of service delivery. Therefore, historic data will likely need to be adjusted for expected price changes, business process re-engineering, etc.

Using the Evaluation Model schedules provides the benefit of a consistent format, which will make review and approval more consistent and efficient.

#### 1. Schedule A - Evaluation Summary

Schedule A is an executive summary, so any comments and descriptions should be high level and brief. This form documents the facts, the process steps taken, the financial reviews performed, and the final decision made by management.

Complete the blue sections. This document is not to be finalized and approved until the competitive contracting bidding process is complete in compliance with all rules and procedures.

**2. Schedule B - Contracting Cost Comparison**

Schedule B summarizes the financial impact of the competing bids for performing the service in-house (current service delivery) versus through the EBU versus obtaining the service from the most responsive outside contractor. The current service delivery and the EBU bid price are supported by Schedules C-1 and C-2 respectively.

At the top of each column, enter the fiscal year and number of months during that year that the contract will be in effect.

Change cost categories if necessary to fit the service in question.

Enter the cost information on this sheet or where desirable on any linked supporting schedules.

**3. Schedule C-1 - Current Service Delivery Cost Projection**

Schedule C-1 provides a summary of all projected direct and indirect costs of the current service delivery approach. This schedule can be used for initial cost analysis using the most recent actual costs as well as during the re-engineering process for cost analysis purposes. For comparison with contractual / EBU projections, the final re-engineered service delivery approach should be used.

The first two cost columns on Schedules C-1 and C-2 are to identify the most recent year of actual service delivery costs and to show the difference between those costs and the projected cost of service delivery in the first year of the proposed contract period. These may be used at the agency's option for management analysis of the reasonableness of the projections. If used, major differences should be explained in supporting documentation.

**4. Schedule C-2 - EBU Bid - Cost Projection (Proposed)**

Schedule C-2 provides a summary of all projected direct, indirect, and other costs for the EBU to deliver the service in question. Both contractual and estimated cost changes are included over the contract term as applicable.

While schedules C-1 and C-2 present projected (or forecast) fully allocated future costs, they will often be based on historic costs.

***Documentation, review, and approval:***

- The data included in each schedule is subject to thorough review. Therefore, all data sources should be well documented. Mainstream accounting system or audited data is preferred where available. It may be advisable to document reasons for key assumptions. Records should be retained at least as long as is required for bid documents.
- Each agency is to determine the appropriate process for review and approval.



*Chapter 3, Section 3***Defining the service and its direct costs****3.3.1 Defining the service****Why is defining the service so important?**

A precise service definition is necessary for accurate cost analyses and comparison with other service provider's cost proposals. In preparing the cost proposal, the agency will need to answer a number of questions. How many employees are needed to provide the service? What kinds of supplies and equipment are used? What portion of an agency's central services is used to support this service? Before these questions can be answered, the agency will need a very good understanding of the service, what is included and what is excluded from the description (see Chapter 2).

When the agency decides to competitively contract a service, it will write an RFP or solicitation. The RFP will include a very detailed definition of the service, including the service's scope, volume, and service/performance requirements. The proposed contract term is also identified in the RFP. If the agency has not yet prepared an RFP, then other information sources will be utilized where the RFP or proposed contract are mentioned in this section.

**Review the RFP carefully to identify proposal parameters**

The first step in the response process is to carefully read the RFP for this service. The service and level of service as described in the RFP should be carefully analyzed. It is critical that the agency's, the EBU's, and the contractor's costs include the same assumptions for service levels and performance measures as indicated in the RFP. This will allow for an accurate comparison of costs using essentially equivalent quality and service levels. There are several particular questions the agency should seek to answer in reading the RFP definition of the work.

***What is the service definition in the RFP?*** - What type of work is described in the RFP? What specific services are mentioned? Is anything explicitly excluded from the RFP?

***What is the term of the contract per the RFP?*** - What is the term of the contract including extensions? When is the anticipated start date? Does the level of service requested vary through the duration of the contract?

***What service specifications does the RFP require?*** - What are the service levels and performance criteria being specified by the RFP? How is this volume expressed (e.g., number of permits issued, number of meals served, etc.)? This data should be expressed in a manner that is consistent with how the market defines the volume data for the service. Is this similar to the way measurable output of the service is described in the agency?

***Any other key decision factors noted?*** - Are there any other conditions or descriptions of the service identified in the RFP?

**Prepare a service description that explicitly defines the agency staff and costs that will be included**

After understanding the scope of the service that the agency intends to purchase, it is time to define the portion of the agency or the service unit that will be compared to external vendors. The service unit may be a portion of a division, the entire division, an entire department or a portion of one or more departments. There are several components to this description that should be included in the Evaluation Model. These will be noted in Section II of Schedule A (see Appendix A of this chapter).

### **Schedule A, Section IIA: Summary description of the scope and nature of the service**

Prepare a brief description of the nature and scope of the service to be provided. These questions may be helpful to determine the key features of the service in preparing the description.

- What work will be performed? What will the agency receive?
- What is the purpose of the work? Who will receive it or benefit from it?
- What agencies or parts of agencies will be involved in providing the work?
- What work typically performed by these units would not be included in this service? Will work new to the unit be provided? What is the scope of this service?
- Where will the service be performed - in one location or at various locations across the state? Do these various locations have different costs of operation?
- What overall levels of service results, in terms of measurable performance standards, are important in determining the value propositions of the eventual bids?

### **Schedule A, Section IIB: Identify the term of the contract and anticipated start date**

Identify the term of the contract in years or months and the anticipated start date. The time period over which cost data is developed and compared should match the term of the contract to be awarded. This will ensure that the service provider decision will be based on the true cost of service over the term of the contract.

Where there are long-term contracts with annual renewal options, the entire potential life of the contract should be used. This approach establishes a base contract cost assuming no options to renew are exercised, and then costs for each renewal option year are added to this base. This revised cost including both the base years and the option years will be the costs used to compare service providers.

### **Schedule A, Section IIC: Describe the expected volume of the service**

Describe the expected volume of service in two components. First, describe the units of service to be provided (e.g., hours, units produced, units serviced, or completed). This expression of units should be consistent with the units expressed in the RFP. Next, describe the volume of service in those units to be provided over the term of the contract.

***How does the agency estimate the expected volume of service?*** - If the agency currently tracks service volumes in the same units identified in the RFP, review the historical records to determine the baseline level of service provided. If the baseline amount is different than the RFP-requested level of service, consider what work unit, process, or resource changes may be necessary to meet the requested level of service.

If the agency has not tracked service levels in the manner specified in the RFP, a study may need to be set up to collect sample data to develop an estimated service level baseline. Agencies are encouraged to contact their financial office or quality coordinator for assistance in setting up such a study.



**Schedule A, Section IID: Identify the key measurable performance standards**

Identify any proposed key measurable performance standards. Some examples of performance standards might include turnaround times, tolerances, error rates, etc. Be sure to address any performance standards identified in the RFP. Other standards may be identified as well. This set of performance standards, to which the work will be done, makes up the minimum set of 'results' for use in evaluating bids' value propositions.

**Schedule A, Section IIE: Describe any other key decision factors considered-**

Note any other key elements of the service description that will help the reviewers evaluate the cost of service. Any specific elements identified in the RFP should be noted.

**3.3.2 Identifying FTEs****Schedule A, Section IIIA: What is an FTE?**

A Full Time Equivalent is defined as one full year of paid employment (the equivalent of 2,088 paid hours), including callback, overtime, and replacement help while an employee takes compensatory time, and all paid leave. FTEs can be expressed in terms of annual or monthly increments. To compute staff years, divide the total number of paid hours by 2,088. To compute staff months, divide the number of hours paid by 174. Remember, paid hours include productive hours as well as paid time off such as annual leave, sick leave, holidays, and paid military leave.

**Identify the number of FTEs to be utilized in providing this service**

Refer to the service definition and its description of the type and level of service to be provided. Identify the number of staff positions, the job classifications of those positions and the staffing levels required throughout the year and throughout the day to perform this service. With this information, calculate the annual FTEs required and record this in Section IIIA of Schedule A.

When the proposed level of service and service delivery approach is the same as that which the agency currently provides, and the staff is fully utilized in providing the service, the agency should be able to use personnel and payroll records to confirm the number of FTEs required.

**What if the proposal includes a different service level than is currently provided to the agency?**

There may be cases however, where the service level requested in the RFP is more or less than the service level currently provided. In this case, the agency may need to analyze the difference in service level requirements to determine whether a different staffing pattern is needed. In other cases, the agency may decide to re-engineer its service delivery for the proposed service and may need to estimate revised staffing needs. Agencies are encouraged to consult their financial offices, personnel managers, quality coordinators, or other applicable staff for assistance with these analyses.

If the number of estimated FTEs to deliver the service will be different than the number of FTEs currently providing this service, please also note the latter in Section IIIA of Schedule A.

**What if only a portion of a person's or unit's time is devoted to this service?**

In many cases, the entire work of a specific service unit will be covered in the scope of a service. In some instances only a portion of a person's time may be devoted to this service. In other cases, only a portion of a unit's services will be covered by the RFP. In these cases, the agency will need to estimate the portion of time staff spends on this particular service. If the

staff already keeps timesheets, these can be used to estimate the FTEs currently used to provide the service.

If this kind of information is not already available, the agency will need to conduct some kind of time tracking or sampling to estimate the portion of staff time spent on the service. Because this study will probably take place over a relatively short period of time, it will be important to adjust this sample time data for any significant seasonal workload variances over the year. Agencies are encouraged to consult their financial offices for assistance with these analyses.

### 3.3.3 Identifying direct costs

#### Schedules C-1 & C-2: What is a direct cost?

Direct costs are those that are consumed or expended for the exclusive benefit of a service and thus are totally (100 percent) chargeable to the service. These costs are directly traceable to the service and are usually charged directly to the service. Usually these costs include staffing, services, supplies, and equipment costs (see WAC 236-51-215 (1)).

*(For any direct service delivery costs that are treated by an agency as indirect costs, see 3.4.1).*

#### Identify direct costs by year in the Service Cost Projection Schedules

In Cost Projection Schedules C-1 and C-2, record the direct costs for the service by year for the term of the contract.

**Note: On Schedules C-1 and C-2 the agency may change the detailed cost categories listed within each of these four categories to better fit their operations or managerial accounting practices.**

The direct costs are divided into four categories:

#### **Schedules C-1 & C-2, Lines 1-5**

**Salaries and Benefits** - This includes all direct personnel salary and benefit costs. (Benefits will be prorated, or allocated on a reasonable basis, for staff that does not devote their full time to the service.)<sup>1</sup>

#### **Schedules C-1 & C-2, Lines 6-17**

**Direct Goods & Services** - Include costs for direct goods and services.

#### **Schedules C-1 & C-2, Lines 18-27**

**Other direct costs** - Any other ongoing direct costs.

#### **Schedules C-1 & C-2, Lines 32-35**

**Other costs** - Includes insurance, one-time or start-up, and transition costs.

#### Use actual costs for the cost proposal when possible

Whenever possible, use actual costs from accounting, allotment, or budget records as the basis for the direct costs. In most cases, the current actual direct costs of service should be used as the starting point with adjustments made to reflect any proposed changes from the current service in service level, service delivery, or performance stan-

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<sup>1</sup>An agency may wish to tailor their Evaluation Model (ref. Schedule A ) with account code references for each cost category. If so, Chapter 75, Uniform Chart of Accounts, of the State Administrative & Accounting Manual (SAAM) may be a useful resource. Web link for this section on object & sub object codes: <http://www.ofm.wa.gov/policy/75.70.htm>

dards. If there are significant fluctuations in costs from year-to-year, which are not related to service volume, additional analysis of those costs over multiple years may be helpful in creating reasonable cost projections.

### **Use these guidelines when estimating direct costs is necessary**

In those cases where the proposed service is different in level, quality, or approach from current practice, the agency will need to make some estimates in determining direct costs. Use these guidelines when developing estimates. Document methods used to develop estimates and also retain supporting schedules (e.g. source data and calculations).

### ***Use the Salary Projection System to estimate staffing costs***

The OFM Salary Projection System (or higher education equivalent) will enable the user to establish staffing models in order to develop accurate staffing cost. Contact the agency budget office for access and assistance.

### ***Use standard costs when available***

Many agencies develop standard costs, for example, standards for the supplies, equipment, and services typically used by an employee that they use in estimating costs for budget decision packages or fiscal notes. Agencies should rely on those accepted standard costing practices when appropriate.

### ***Consider cost surveys to identify new cost elements***

The development of an estimated budget may require surveying providers of similar services, supplies, and start-up costs, particularly if these are new cost elements to the agency. The survey results should be modified as needed to reflect any differences in how the agency plans to provide the service from those surveyed.

### ***Use staffing analyses or sampling methods to estimate portion of shared direct costs***

As mentioned in the FTE section, some services proposed for competitive contracting may only be one component of a work unit's work. In these cases, the agency will need to estimate the cost of the portion of staff and resource used for this service. Staff time estimates can be used to determine the portion of direct staff costs attributable to the service. In many cases, the staff time percentage may be an appropriate allocation basis for allocating the other direct costs to the service. If certain supplies and services are used for this service in a ratio much different than the staffing ratio, the agency should perform a use study to better estimate the portion resources consumed for this service.

### **Should inflation be included?**

Schedules C-1, Lines 39-43 & C-2, Lines 38-42

Schedules B, Lines 29-35

Use inflation factors based on economic forecasts of the Implicit Price Deflator (IPD) for personal consumption, as measured by the U.S. Department of Commerce. The IPD is used because it is considered more representative of the general mix of goods and services purchased by the state than other indicators available. The other primary inflation index, the Consumer Price Index (CPI), may not adequately allow for the effects of technology and quality changes. In certain cases, medical costs, for example, a special inflation rate may be utilized when justified (see 3.7). On Schedules C-1, lines 39-43 and C-2, lines 38 to 42 may be used for inflation factors or estimated/scheduled cost increases, or they may be documented and calculated in other ways. Likewise lines 29 to 35 on Schedule B may be used for this purpose.

For payroll costs, when available, use contractual increases instead of inflation factors.

### 3.3.4 Equipment and capital costs

#### Equipment costs need to be included

Schedules C-1 & C-2, Line 8

Schedules C-1 & C-2, Lines 20-22

RCW 41.06.142 requires that the cost of equipment used by an EBU be included in its bid because it is part of the cost of providing the service just like any other direct cost. However, because capital equipment has a useful life that may cover all or a portion of the contract term, these costs need to be treated differently than the costs of supplies.

An asset plan may be useful in reviewing the estimated life cycle, operating costs and timing of replacement purchases. The asset plan, for example, would assess the risk of equipment failure as its use approaches (or exceeds) its estimated useful life (chapter 4 discusses risk assessments in greater detail). The asset plan will also estimate repair costs, which would typically increase the longer the asset is used. An asset plan may also evaluate the costs and benefits of acquiring new equipment, which may be more efficient to operate.

This section provides guidance on how to determine the fair portion of equipment costs to include in the cost of the service. The approaches for proprietary fund activities and governmental fund activities differ.

#### Equipment costing approach for proprietary fund services

State proprietary funds, which operate similarly to private sector business, utilize accrual accounting. As applied to capital equipment, that means that the cost of equipment is spread over the period of its useful life through depreciation and is thus matched to the revenues generated by the service. The equipment cost would include depreciation, equipment maintenance, and repair costs incurred during the term of the service under evaluation or bid.

#### Equipment (Capital Asset) costing approach for governmental fund services

The accounting records for state governmental funds, which represent the majority of state operations, are maintained using the generally accepted approach for governmental funds - the modified accrual basis of accounting and the current financial resources measurement focus. Using this approach, the cost of equipment is treated as expenditure in the year the equipment is purchased rather than being depreciated over its useful life.

To conform to the PSRA of 2002 requirements, a competitive contracting evaluation or EBU bid must spread the cost of equipment over its useful life. Accordingly, the expenditures for the capital assets related to the service delivery as recorded in the governmental fund's accounting records must be removed and replaced with depreciation expense - the proportionate cost of the capital asset utilized in each service period. Pro-forma depreciation must conform to state policies for capital asset depreciation (see the State Administrative and Accounting Manual (SAAM) Section 30.20; web link: <http://www.ofm.wa.gov/policy/30.20.htm>).

#### Charge a “usage fee” as an alternative approach

Practical alternatives to calculating pro-forma depreciation could include “charging” a reasonable usage (rental) fee, which would approximate the actual cost of the asset over its useful life. Again, the equipment cost would include all depreciation, use fees, equipment maintenance, and repair costs incurred during the term of the service under evaluation or bid.

**Note:** *All adjustments and charges described above would be for competitive contracting purposes only and would not result in adjustments to the state accounting records.*

### **3.3.5 Other costs - Includes insurance, one-time or start-up, and transition costs**

#### **How to treat one-time or start-up costs**

Schedules C-1, Lines 32-36 & C-2, Lines 32-35

Significant start-up costs that provide benefits over the life of the contract and beyond need to be addressed to ensure consistent treatment. Under this guide, initial investments should be expensed in the year the costs are incurred.

Normally the current service cost on Schedule C-1 would not have start-up costs. An exception might occur due to process reengineering changes, possibly made during the employee alternatives phase.

#### *Chapter 3, Section 4*

### **Defining indirect costs**

#### **3.4.1 Defining indirect costs**

##### **Defining indirect costs of the state service (whether performed by an EBU or regular agency staff)**

Schedules C-1, Lines 29-30 & C-2, Lines 29-31

The treatment of indirect costs can greatly affect the outcome of the analysis and should be dealt with in a consistent and logical manner. Indirect costs are those linked to services, but cannot be practically or economically assigned directly. Indirect costs that typically support the entire agency or state government should be considered and evaluated to determine which components are directly attributable to specific services and are avoidable (as defined below).

The Office of Financial Management identifies statewide indirect costs (see Section 50.20 of the SAAM). These costs are incurred by service type agencies in support of other agencies and are not billed to the benefiting agencies. These include statewide administrative and support costs which are allowable under federal cost circulars.

Each agency is also billed directly for certain statewide services, such as those provided by the State Auditor, the Department of General Administration, the Office of Financial Management, and the Department of Personnel. While these statewide costs are billed directly to agencies, they are normally considered indirect costs to the various services provided by the agency.

Within the agency, indirect costs are incurred at the agency level for employees providing administrative, supervisory, and support services to some or all of its service units. Some examples are the director's office, human resources, accounting and budget, library and media services, counseling, financial aid, facilities maintenance, and security.

Within an agency, indirect costs may also be incurred within a division that supports multiple services and that cannot be allocated directly to the various services. Typical costs include: (1) employees providing administrative, supervisory, and support services, and (2) related services, supplies, and other charges provided to multiple services within the division.

**Note:** *If an entire operating program is the service unit under review, indirect costs do not include operating program overhead costs incurred within that unit. These fully dedicated overhead costs are considered direct costs and are*

***included as such when determining the cost of a given service. Examples of dedicated service overhead include employees providing administrative, supervisory and support services, supplies, and other charges directly supporting the service.***

### **How does an agency establish indirect costs?**

There are a number of means to capture indirect costs related to the service being analyzed or bid. Since methods can range from simple to complex, an agency should use the simplest method that provides enough information to adequately project indirect costs.

Some large agencies have federally approved indirect cost plans developed in accordance with federal cost circulars. If an agency has a federally approved indirect cost allocation plan, it may use the plan as a starting place to quantify indirect costs. In using this method, an adjustment will be required for any and all elements that are not directly attributable to the particular service. One reason for starting with a federal cost plan is because federal requirements mandate fair and equitable treatment of costs.

Alternatively, the agency may develop its own indirect cost rate by analyzing and identifying its pool of indirect costs in comparison to direct program expenditures. This may be a fairly complex and difficult process for some agencies. If the detailed list approach is used, the chart of allowable costs from **OMB Circular A-87** for state government or **OMB Circular A-21** for higher education (Appendices B and C) may be used as a checklist for potential costs to be considered in developing the cost projections.

One of the difficulties in defining indirect costs is that each situation may be different. For example, in many agencies, information technology (IT) costs may have direct and indirect components, but if the service under review is an IT unit itself, most of the IT costs will be direct, but there may be other services (such as human resources) that may have an indirect IT component.

### **Defining avoidable and unavoidable indirect costs**

Avoidable and unavoidable indirect costs as envisioned in this statute can be defined as follows:

#### ***Avoidable indirect costs***

Those indirect costs that would be reduced or eliminated if a service currently provided by agency staff were to be provided by an outside contractor. These costs can include a portion of indirect costs that can be eliminated over the life of the service contract. Avoidable indirect costs are, by their indirect nature, more difficult to identify than direct costs. In some circumstances, it will be clear that some costs included in an agency's indirect cost pool can or will be reduced or eliminated as a result of competitive contracting a service formerly performed in-house.

#### ***Unavoidable indirect costs***

Those indirect costs that the agency incurs regardless of whether a service is provided by the agency or by an outside contractor. These costs can include a portion of indirect costs at the statewide, agency, or division level, because these costs may not be eliminated as a result of competitive contracting. Unavoidable indirect costs support the entire agency or state government, are not directly attributable to specific programs, and are not affected by typical fluctuations in service levels.

### **Determining avoidable and unavoidable indirect costs**

Once indirect costs are identified, the next step is to determine which portions of those costs are avoidable and unavoidable. RCW 41.06.142 states that "An employee business



unit's bid must include the fully allocated costs of the service..." but exclude state indirect costs "...unless those costs can be attributed directly to the service in question and would not exist if that service were not performed in state service." In other words within competitive contracting; only indirect costs that are avoidable are included in the cost of state service, whether performed by regular agency staff or an EBU (see WAC 236-51-215).

The one exception to including only avoidable indirect costs would be for any direct costs of service delivery, which the agency allocates as if they were indirect costs. For example, the agency may house several service delivery programs within one building that all use significant amounts of electricity, which is a direct cost in the delivery of those services. However the agency may allocate electricity costs in an indirect cost rate because separate electricity meters are not available to facilitate direct charges to each service. The law states that the service cost "must include the fully allocated costs of the service, including the cost of the **employees' salaries and benefits, space, equipment, materials, and other costs necessary to perform the service**" (RCW 41.06.142 (4) (e); emphasis added). If any of these direct service delivery costs are treated as indirect, then they must be included in the service cost, whether avoidable or not. For example, rent for the direct service delivery facility is also part of the "space" direct costs and, even if it is allocated to the service within an indirect cost allocation, it must be included in service costs even if it is not considered avoidable. However, any such costs that can not be avoided (or utilized for another purpose), whether for a period of time or permanently, will be added to the cost of competitive contracting on Schedule B.

### Identifying avoidable and unavoidable indirect costs

To identify avoidable and unavoidable indirect costs, it may be helpful to begin by asking the question, "Will contracting this service currently accomplished by agency staff actually increase or decrease the indirect costs of the agency?" For example, if a given service is contracted with an outside contractor will it result in the elimination or acquisition of indirect support service costs, such as some of their telephones, electronic data processing programming, utilities, leases, or mail station? Any amount of indirect costs that would be eliminated will be the avoidable indirect costs identified in Schedules C-1 and C-2.

As a general rule, the larger the service under evaluation, in proportion to the agency's total service activity, the greater the percentage of the agency level indirect costs that would generally be classified as avoidable. The agency level indirect costs that can be attributed directly to the service and are avoidable would be included on Schedules C-1 and C-2. It is recommended that the agency's financial office be consulted before classifying such costs as avoidable.

If multiple services end up being contracted out, management would continue its normal practice of reevaluating the appropriate levels of indirect support for their agency. Supplemental reductions would be made where in the aggregate the changes have reduced the indirect support needs beyond what was identified in the separate analyses.

In some instances, avoidable and unavoidable indirect costs may shift over the life of the contract or time period for cost comparison analysis. For instance, an unavoidable cost may be incurred in the first year, but as a result of planned efficiency and effectiveness, a portion or all of this unavoidable cost may become avoidable in the second year. One example might be a plan to switch from transactional invoicing to weekly summary billings for services, which would reduce some costs such as the state's accounts receivable systems charges (that are in part based on invoice volume). Factors to consider in identifying these time-delayed avoidable costs include:

- Employee training and relocation
- Purchase/sale of assets

- Property leases’
- Inflation
- Contract and grant cancellation/expiration

These temporarily unavoidable indirect costs should be classified under Other Costs on Cost Projection Schedules C-1 and C-2.

Except for the required detail cost category for “Contract Administration, Monitoring, and QA” (line 31) on Schedule C-2, the agency may change the detailed cost categories listed within the indirect and other cost categories to better fit their operations or managerial accounting practices.

For purposes of initial agency analysis or comparing competitive contracting bids, the costs of the service within the agency should include fully allocated indirect costs, and then show a separate line for reduction of those indirect costs not directly attributable to the service. (This is the suggested approach for use within an indirect cost supporting schedule, not necessarily directly on Schedules C-1 or C-2.)

Cost Projection Schedules C-1 and C-2 provide a reference number column for supporting schedules. Rationale should be provided for each indirect cost line item to discuss the breakdown between avoidable and unavoidable costs.

### *Chapter 3, Section 5*

## **Cost allocation methods**

### **3.5.1 Defining cost allocation**

#### **What is cost allocation?**

Cost allocation is the process of assigning a cost to one or more services in reasonable and realistic proportion to the benefit provided or other equitable relationship.

#### **What purpose does cost allocation serve?**

Cost allocation allows the agency to determine the true and total costs incurred in providing a service. Once the agency knows the full cost of a service, it can make better management decisions related to that service.

#### **What types of costs should be allocated?**

Some direct costs and all indirect costs should be allocated. A direct cost such as rent needs to be allocated when more than one service is covered by a single rent payment. Examples of indirect costs that should be allocated include costs associated with an agency’s human resources, fiscal, or information technology services.

#### **Are there general guidelines for allocating costs?**

General cost allocation guidelines that should be considered include:

- The cost allocation approach should be fair, equitable, and easy to understand.
- The cost allocation approach should be efficient to calculate and implement.
- The approach should allocate costs using bases that are reasonable surrogates for the cost drivers.

- Costs should be allocated to all services that are users of resources or recipients of internal services.

### **Do all agencies allocate the same costs?**

Because of the diverse characteristics and accounting practices of state agencies, the types of costs that must be allocated vary from agency to agency. An agency that has only one service would be able to directly associate all of its costs with that one service; whereas, an agency that has multiple services must accumulate its common costs and then allocate them to the benefiting services.

Even agencies with multiple services can be organized quite differently. For example, one agency might decentralize its information services support by assigning technical support staff within the service, whereas another might maintain a central Help Desk service.

### **What costs are included in the fully allocated cost of a service?**

All costs incurred by the agency must be spread to the agency's services either through a direct charge or an allocation. Once all costs are assigned to the agency's services, they can be separated between avoidable and unavoidable.

## **3.5.2 Cost allocation components**

### **What are the components of cost allocation?**

Cost allocation components include:

- **Allocable costs** - A cost is allocable to a particular service in accordance with the relative benefits received. The costs incurred are specifically for the service and can be distributed in reasonable proportion to the benefits received and are necessary to the overall operation of the agency/service.
- **Cost allocation base** - A systematic means of relating a given cost or cost pool with a cost objective. In general, any cost element or related factor associated with the agency's services can serve as a cost allocation method provided that it can readily be expressed in terms of dollars or other quantitative measures, and is common to the benefited services during the base period. The choice of the allocation method should be guided by the purpose to be served by the cost allocation and the necessary administrative costs and effort in the allocation (see 3.5.3).
- **Cost pool** - Any grouping of individual costs.
- **Cost objective** - Any service for which a separate measurement of costs is desired.
- **Cost allocation rate** - The ratio (expressed as a percentage) of the costs to be allocated to the direct cost allocation base.
- **Base period** - The period in which costs are incurred and accumulated for allocation to services. The base period should normally be the state's fiscal year.

## **3.5.3 Cost allocation methods**

### **How are costs allocated?**

When the agency has several services that benefit from its allocable costs in varying degrees, the agency must accumulate its allocable costs into separate cost pools. Each cost pool should then be allocated individually to benefiting services using an appropriate allocation method.

### What are some common allocation methods?

Some common cost allocation methods and their descriptions are:

- **FTE** - Costs are allocated based on the number of FTEs involved.
- **Case/person counts** - Costs are allocated based on the population served (case/claims/clients/participants/average resident population/enrollment/student FTEs).
- **Square footage** - Costs are allocated based on the square footage occupied by the service.
- **Dollars disbursed** - Costs in one area are allocated based on dollars disbursed in another area.
- **Staff effort** - Costs are allocated based on hours worked or services performed by agency or contracted staff. This information is gathered in the form of random moment time samples, time sheets, day logs, time studies, etc., and is updated daily, monthly, quarterly, or annually.
- **Fixed rates / percentages** - Costs are allocated based on rates or percentages agreed upon by agency and an outside entity such as the federal funding unit(s) involved.
- **FTEs disbursed** - Costs in one area are allocated based on the FTEs disbursed in another area.
- **Grant awards** - Costs are allocated based on the grant awards.
- **Interim per diem rates** - Costs are allocated based on historical costs multiplied by the number of eligible resident days in an agency facility.
- **Pieces mailed** - Costs are allocated based on the type and number of pieces of mail distributed monthly.

### Is an agency limited to using only one allocation method?

An agency should consider the cost allocation general guidelines. For some agencies, one cost pool and one allocation method will allow for both equitable and efficient distribution of costs. For other agencies, however, multiple cost pools and methods may be needed to satisfy the cost allocation general guidelines. Retain good documentation of the methods, sources, calculations, and results of cost allocations.

#### **Example 1**

An agency leases a 2,500 square foot facility to house 100 staff - 60 working in Service A and 40 in Service B. Services A and B are both consulting-type services and require fairly consistent workspace use. The lease is \$6,000 per month. The facility has 500 square feet of common areas (hallways, bathrooms, etc.). Staff for Service A occupies 1,200 square feet and staff for Service B occupies 800 square feet.

#### **FTE method:**

Service A:  $60/100 \times \$6,000 = \$3,600$

Service B:  $40/100 \times \$6,000 = \$2,400$

#### **Square footage method:**

Service A:  $1,200/2,000 \times \$6,000 = \$3,600$

Service B:  $800/2,000 \times \$6,000 = \$2,400$

In this instance, because number of staff per square foot is comparable between the services, allocating the rent to Services A and B on an FTE basis and on a square footage basis result in the same lease charge.

### **Example 2**

An agency leases a 4,000 square foot facility to house 100 staff - 80 working in Service A and 20 in Service B. Service A is a consulting-type service and Service B is a sales service requiring space to display inventory items sold. The lease is \$9,000 per month. The facility has 1,000 square feet of common areas (hallways, bathrooms, etc.). Staff for Service A occupies 1,500 square feet and staff for Service B occupies 1,500 square feet.

#### **FTE method:**

Service A:  $80/100 \times \$9,000 = \$7,200$

Service B:  $20/100 \times \$9,000 = \$1,800$

#### **Square footage method:**

Service A:  $1,500/3,000 \times \$9,000 = \$4,500$

Service B:  $1,500/3,000 \times \$9,000 = \$4,500$

In this instance, because the number of staff per square foot is not comparable, allocating the rents to Services A and B on an FTE basis and on a square footage basis have very different outcomes. In order for the cost allocation to be equitable, the square footage method would be preferable.

## *Chapter 3, Section 6*

### **Calculating the costs of competitive contracting**

#### **3.6.1 Costs of competitive contracting**

##### **Competitive contracting costs**

Schedule B, Lines 3-26

Schedule C-1, Line 33

Schedule C-2, Lines 31-36

If a service is contracted out, costs may be incurred in several categories. In addition to contractor payments, there may be additional taxes, contract administration expenses, inflation costs, and costs to transition the service to the outside contractor. The cost of contracting can not include any costs that are related to the competitive contracting solicitation process. Cost adjustments are required when the state assumes risks, but requires contractors to insure those same risks. In some cases, there may be state revenue changes, which are part of the financial impact. The purpose of this section is to capture the total net cost to the state related to the option of competitive contracting a service (see WAC 236-51-306).

On Schedule B, the agency may change the detailed cost categories listed within the major cost category headings to better fit their operations or managerial accounting practices.

Although this section covers the costs of competitive contracting on Schedule B, many of these same cost components also will apply to EBU contracting costs on Schedule C-2. The only potential impact of Section 6 to current service delivery costs on Schedule C-1 would be if there is an adjustment(s) for the cost of state assumed risks as described in section 3.6.2.

### 3.6.2 Total outside contractor price

#### Contractor price

Schedule B, Line 4

The contractor price is the sum total of all payments to be made to the contractor. If the bid includes cost of living adjustments (COLAs), the same inflation assumptions should be made as were used in the internal cost estimate. (This does not mean that any inflation factors used must be identical, if the differences are reasonable.) Management judgment may be involved if there are contingent payments, such as performance bonuses. For the purpose of these calculations, it should be assumed that the contractor's performance would meet or exceed the RFP requirements.

#### Adjustment for costs related to the state's assumed risks

Schedule B, Line 5

##### ***Example: Required performance bonds not obtained by the state:***

When a solicitation requires only non-EBU bidders to provide a performance bond, which it does not obtain, the agency shall exclude the cost from the non-EBU's bid price (see WAC 236-51-306 (5) (b)) and comment on required insurance in 3.6.4).

### 3.6.3 Sales (or other) tax on contractor services

#### Sales (or other) tax

Schedule B, Line 6

In some cases, the agency may be liable to pay incremental state/local taxes beyond paying the contractor's bid amount. The agency should check the tax codes (e.g. RCW 82.04.050) to determine whether sales tax (or any other tax) will be payable on the services performed if they are awarded to a contractor. A sales tax on the contractor's service would have a relatively small net impact to the state as a whole, which is caused by the local portion of sales tax paid. However, the tax liability may be significant to the agency's cost of operations if the service is contracted out. Because local tax rates vary, it may be important to determine the "place of sale" to calculate the taxes due. If federal funding is involved, the agency should verify that any tax is an allowable cost.

Any sales/use tax impact on goods being purchased for the service in question will not be impacted by whether the service is performed by an outside contractor or in-house. The agency will pay the tax on goods regardless. However, if the purchase of goods is part of the contractor's bid, the agency should determine whether their bid price for the goods does include the appropriate sales tax. If not, include that sales tax on goods here also.

The tax payments listed here would be deducted in the revenue changes section, to the extent that they are taxes not already being paid by the agency, because they increase state general fund revenue.

#### ***Examples of sales or other taxes***

The following common examples are included for illustrative purposes only. Because tax rules can be complex, each situation should be evaluated separately based on its circumstances.

Examples of services subject to sales tax may include building maintenance, repair, construction, cleaning, painting, remodeling, equipment (including computer) repair and maintenance, landscape maintenance, laundry services, mailing services, and vehicle maintenance and repairs.



RCW 82.04.050 defines retail sales in the state of Washington.

Examples of specific exemptions from sales tax include janitorial services; building, maintaining or repairing of government roads (except for state roads); and certain personal services (e.g. attorneys, doctors, dentists, architects, engineers, and public accountants).

Examples of “other taxes” may include fuel tax, rental car tax, leasehold excise tax, or food and beverage tax. Under the terms of a contract, vendors may pass on their costs for personal or real property taxes to the state. Agencies may be required to collect leasehold excise tax on state real property used by non-government organizations (RCW Chapter 82.29A).

### **Example situation**

Consider the table in *Figure 16*, for example, if a vehicle maintenance service section were under a competitive contracting evaluation. (For the Outside contractor column, it is assumed that the various agencies contract directly with the contractor, e.g. the Department of XYZ Vehicle Maintenance Service Section no longer exists.)

**Figure 16**

*Tax  
Comparison  
Example*

Vehicle Maintenance Service Section	Outside Contractor
No taxes charged to agencies.	Charges agencies the car rental tax on short-term rentals or retail sales tax on long-term.
Pays sales tax on parts / supplies.	Pays sales tax on parts / supplies.
Pays state taxes on fuel, but does not pay federal excise taxes (FET) on fuel or tires.	Pays state and FET taxes on fuel and pays FET on tires.
<i>Alternate Scenario - If the agency owns the vehicles and only contracts for fleet management and maintenance:</i>	
No tax is charged to agencies except for external maintenance labor and taxes on materials.	Retail sales tax is charged to the agency on all maintenance services.

## **3.6.4 Cost to agency for contract administration and support**

### **Contract administration and support**

Schedule B, Lines 7-16

Schedule C-2, Line 31

Who will be overseeing the contract/contractor to ensure service delivery? What are the costs associated with oversight?

Contract administration costs are incurred in administering a contract, whether it is with an EBU or a contractor. It includes the cost of reviewing compliance with the terms of the contract, resolving any performance deficiencies, processing payments, negotiating change orders, reporting, quality assurance, and performance monitoring of the closeout of contract operations. Under some circumstances the cost of contract administration may vary between the EBU and outside contractor scenarios (see Chapter 7 of this manual or Chapter 8 of the OFM Guide to Personal Services Contracting for more detailed guidance on contract management and monitoring link: <http://www.ofm.wa.gov/contracts/psc/psc8.doc>).

**Note: *Contract administration and transition costs need to be added to the EBU proposal (C2), the same elements should apply as those related to a contractor's proposal.***

### **Examples of cost considerations**

Some examples of cost considerations are as follows:

#### ***Possible additional monitoring if federal funds are involved***

Consider whether there will be special monitoring requirements due to the involvement of federal funds.

#### ***Travel and transportation***

Consider if there will be travel and transportation expenses associated with site visits to ensure that contract obligations are being met.

#### ***Personal service contracts***

Consider the potential costs of competitive contracting some parts of contract monitoring (such as monitoring in remote regions).

#### ***Standby equipment/services***

Consider the costs of maintaining a backup plan in the event the contractor fails to perform a vital service.

#### ***State furnished equipment / property***

Consider whether the agency or the contractor will be supplying the equipment, space, or supplies.

#### ***Other costs, including those related to state assumed risks***

Consider other costs for contract administration, such as:

- Liability insurance
- Cost of State Assumed Risks - For example, in the case of self insurance the agency must consider the cost of assumed risks where relevant to a bid evaluation. For example, if insurance is required of outside contractors, which the agency does not obtain, then the agency's current service cost (Schedule C-1) and the contract administration cost for the EBU (Schedule C-2) must include the estimated cost of such insurance premiums (e.g. casualty, liability and property insurance covering assets and/or liability risk) (see WAC 236-51-306 (5) (a))
- (See discussion on performance bonds in section 3.6.2)
- One-time costs (purchases for contract administration)
- Legal
- Audit (performance or financial)
- Possible amendments to the contract or change orders
- Processing of contractor invoices, cost of issuing payments
- Background checks, security clearances, and identification badges for contractors that may work with vulnerable citizens (unless the contractor is required to pay these costs)

### 3.6.5 Transition costs

#### Transition costs

Schedule B, Lines 17-23

Schedule C-2, Line 35

A conversion to competitive contracting may require an agency to incur costs that would not have occurred if the service were continued in-house.

**The following costs should be considered when determining the total cost for competitive contracting:**

#### Personnel costs

Will the contract cause reductions-in-force (RIF's) of current employees? What is the estimated financial impact (e.g. employee severance, re-location, re-training)?

Estimate the number of personnel impacted and the dollar value of the estimated payments that will be made for costs such as unemployment and fringe benefits (i.e. leave earned but not accrued).

***Note: State agencies do not pay unemployment insurance premiums, but instead are invoiced by the Department of Employment Security for benefits actually paid out to former state employees. Proprietary and fiduciary funds recognize annual and sick leave expenses as it is earned. However, governmental funds do not record annual and sick leave expenditures until they are paid.***

#### Disposition of assets

Will the contract result in the surplus of state equipment? Will the sale of assets result in a gain or loss? What are the costs involved with the transfer of assets?

#### Current lease/contract cancellation

Will the contract result in unoccupied leased facilities? Will there be a penalty fee for early termination of the current space or equipment lease?

Leased assets should be managed to minimize the transition costs to the state. If termination is not allowed, or lease / contract cannot be absorbed within the agency or alternative utilization is determined to not be cost effective, what would the cost be of letting natural expiration occur?

#### One-time and/or long-term costs

Are there any other transition costs, such as self-insurance or litigation costs?

#### Future costs eliminated (if not listed above)

Are there any other reductions or elimination of costs due to the transition, such as custodial or storage costs?

### 3.6.6 Increase or decrease in revenue

#### Revenue changes, if any

Schedule B, Lines 24-25

Schedule C1 , Line 36 & C-2, Line 37

Offsetting revenue is any new or enhanced revenue stream that will accrue to the agency, or the state, as a result of contracting for a service (e.g. an increase in tax revenue is an offsetting revenue that must be deducted from the total contract price) (see WAC 236-51-306 (4) (c)).

For example, if the contractor is more effective in billing and collecting fines, the agency's revenues may increase, thus reducing the net cost of services. Also, most outside contractors will pay incremental business and occupation (B&O) taxes or federal excise taxes (only the portion directly benefiting the state would be listed). If sales (or other) tax on the contracted services was listed as a cost, it must be added back here as a state revenue. However, if the state already pays a particular tax it would not be added here because it is not incremental revenue.

Normally the current service cost on Schedule C-1 would not have any revenue changes. An exception might occur due to process reengineering changes, possibly made during the employee alternatives phase.

### *Chapter 3, Section 7*

## **Resources**

### **3.7.1 Internet resources**

#### **Federal Office of Management and Budget (OMB) Circulars**

1. A-21: Cost Principles for Educational Institutions  
<http://www.whitehouse.gov/omb/circulars/ao21/print/ao21.html>
2. A-76: Performance of Commercial Activities  
[http://www.whitehouse.gov/omb/circulars/ao76/a76\\_rev2003.pdf](http://www.whitehouse.gov/omb/circulars/ao76/a76_rev2003.pdf)
3. A-87: Cost Principles for State, Local, and Indian Tribal Governments  
<http://www.whitehouse.gov/omb/circulars/ao87/print/ao87-all.html>

#### **Tax information from the Department of Revenue**

1. Business Tax Guide 2002  
[http://dor.wa.gov/Docs/Pubs/ExciseTax/FilTaxReturn/CETR\\_MQ\\_Guide\\_02.pdf](http://dor.wa.gov/Docs/Pubs/ExciseTax/FilTaxReturn/CETR_MQ_Guide_02.pdf)
2. Matrix of Major Taxes in Washington State  
<http://dor.wa.gov/Docs/Pubs/ExciseTax/FilTaxReturn/MajorTaxes.htm>
3. Retail Sales Tax Brochure  
[http://dor.wa.gov/Docs/Pubs/ExciseTax/RetailSales\\_UseTax/RetailSales.pdf](http://dor.wa.gov/Docs/Pubs/ExciseTax/RetailSales_UseTax/RetailSales.pdf)
4. Sales Tax Rates Address Lookup (GIS) Tool  
[http://gis.dor.wa.gov/lookups/gis\\_look\\_sales.asp](http://gis.dor.wa.gov/lookups/gis_look_sales.asp)
5. Use Tax Brochure  
[http://dor.wa.gov/Docs/Pubs/ExciseTax/RetailSales\\_UseTax/UseTax.pdf](http://dor.wa.gov/Docs/Pubs/ExciseTax/RetailSales_UseTax/UseTax.pdf)

#### **Enabling legislation**

1. Personnel System Reform Act of 2002 (Substitute House Bill 1268):  
[http://www.leg.wa.gov/pub/billinfo/2001-02/House/1250-1274/1268-s\\_pl.pdf](http://www.leg.wa.gov/pub/billinfo/2001-02/House/1250-1274/1268-s_pl.pdf)
2. Civil Service Reform (Department of Personnel)  
<http://hr.dop.wa.gov/hrreform/default.htm>
3. Revised Code of Washington (RCW) 41.06.142  
<http://www.leg.wa.gov/RCW/index.cfm?fuseaction=section&section=41.06.142>

**3.7.2 Other resources****Competitive contracting support services**

Any agency may contract with the Department of General Administration to perform a competitive contracting bidding process (see RCW 41.06.142 (4) (f)). The Department of General Administration has created a pre-qualified list of contractors, which can provide an agency with a full range of consulting services in support of a competitive contracting process.

<http://www.ga.wa.gov/competitivecontracting/documents/AssistingVendor.doc>

**General guidance on conducting solicitations**

See these general guidance documents and resources.

<http://www.ga.wa.gov/PCA/regulat.htm>

**General guidance on IT-related contracting**

See ISB policies, standards and guidelines and other resources.

<http://dis.wa.gov/portfolio/index.htm>

**Information Services Board (ISB)**

See ISB website for information about the Information Services Board (ISB)

<http://www.dis.wa.gov/isb/>

**Statewide accounting policies and procedures**

See the Office of Financial Management's web site for the State Administrative and Accounting Manual (SAAM) and other resources.

<http://www.ofm.wa.gov/accounting/policies.htm>

**General inflation resources**

Washington State Office of the Forecast Council: (See their Quarterly Economic and Revenue Forecast Publications for updates on the Consumer Price Index (CPI) and Implicit Price Deflator (IPD) among other economic measures and forecast information.)

<http://www.erfc.wa.gov/>

(For background information about the CPI and IPD and the differences between them, see report titled, An Examination of the Difference Between the CPI and the PCE Deflator, at

<http://stats.bls.gov/ore/pdf/eco20100.pdf>)

Certain cost categories may experience inflation that is higher or lower than these overall averages. For example, health care cost increases have been much higher than the CPI in the recent past. Where these special cost categories are a significant component of service costs, use of other inflation estimates may be advisable. Other cost categories are set by policy, regulation, or statute and may not be correlated with general inflation rates (e.g. state employee salary and benefit costs, travel reimbursement rates, state agency internal service fund costs such as attorney general, audit services, etc.) In these cases use known rate increases rather than general inflation estimates. The cost categories on the following list are suggested for the use of either known or estimated rate increases, rather than general inflation factors, where the difference would be significant.

State Code (Object/Sub)	Cost Category Description
A	Salaries And Wages
B	Employee Benefits
GA	In-State Subsistence and Lodging
GC	Private Automobile Mileage
GF	Out-of-State Subsistence and Lodging
GN	Motor Pool Services
EB	Communications
EK	Facilities and Services
EL	Data Processing Services
EM	Attorney General Services
EN	Personnel Services
EP	Insurance
ET	Audit Services
EV	Administrative Hearings Services
EW	Archives and Records Management Services
EX	OMWBE Services
S	Interagency Reimbursements
T	Intra-Agency Reimbursements

### Chapter 3 **COST OF GOVERNMENT SERVICES APPENDICES**

#### **APPENDIX A: Evaluation Model (Schedules A, B, C-1, and C-2)**

The evaluation model is a stand alone Excel " Spreadsheet. The following are links to the templates.



*click on each template below for a downloadable Excel file*

[Schedule A - Evaluation Summary](#)

[Schedule B - Contracting Cost Comparison](#)

[Schedule C 1 - Current Service Delivery](#)

[Schedule C 2 EBU Bid](#)

## APPENDIX B **Chart of Allowable Costs: Federal Office of Management and Budget (OMB) Circular A-87**

**Purpose:** To identify allowable and unallowable costs under A-87 for analysis for potential adjustment to agency indirect cost rates under A-87 if agencies use those in developing costs for Competitive Contracting. For those agencies without a federally approved indirect cost plan, this list could be used to determine which things to include as indirect costs in agency / employee proposals.

A-87 Cost Item	Allowable Under A-87?	Include in WA State Model?	Comments
Accounting (cost of establishing & maintaining systems)	Yes	Yes	
Advertising and Public Relations Costs	Yes, limited	Yes	For hiring notices
Advisory Council	Yes	No	
Alcoholic Beverages	No	No	
Audit Services	Yes	Yes	
Automatic Electronic Data Processing	Yes	Yes	
Bad Debts	No, unless in fed regulations	No	
Bonding Costs	Yes	Yes	
Budgeting	Yes	Yes	
Communications (telephone, mail, messenger, etc.)	Yes	Yes	
Compensation for Personnel Services:		Yes	
Generally all remuneration (wages, salaries & fringe benefits)	Yes	Yes	
Fringe benefits (leave, employee insurance, pensions, unemployment benefit plans, etc.)	Yes	Yes	
Pension plan costs	Yes, may be limited	Yes	
Post-retirement health benefits	N/A	No	Retirees pay cost of own health insurance
Severance pay	Some	No	Yes for A-87, if associated with normal turnover. If abnormal or mass severance pay, considered on a case-by-case basis

A-87 Cost Item	Allowable Under A-87?	Include in WA State Model?	Comments
Support of salaries and wages	N/A	No	This is not a cost item, but a requirement related to payroll documentation standards.
Donated services	No	No	May be used to meet match. Considered in determination of indirect cost rate if material.
Contingencies	No	No	
Contributions and donations	No	No	
Defense and prosecution of criminal and civil proceedings, and claims:			
- Required in administration of federal programs	Yes	Yes	
- Prosecution against federal government	No	No	
Depreciation and use allowances	Yes, mostly	Yes	A-87 excludes cost of land in most cases, any costs of buildings or equipment borne or donated by the feds, any costs contributed by or for the governmental unit in satisfaction of a matching requirement
Disbursing service (Treasurer costs)	Yes	Yes	
Employee morale, health, and welfare costs	Yes	Yes, with parameters	
Entertainment	No	No	
Equipment and other capital expenditures	Yes	Yes	
Fines and penalties	No, generally	No	Except when incurred as a result of compliance with specific provisions of the federal award or written instructions by awarding agency
Fund raising and investment management costs	No	No	Except investment costs associated with pension or self-insurance funds
Gains and losses on disposition of depreciable property and other capital assets and substantial relocation of Federal programs	Yes	No	Generally treated as an adjustment to the appropriate asset cost grouping. Items were bought under "equipment" and then depreciated

A-87 Cost Item	Allowable Under A-87?	Include in WA State Model?	Comments
General government expenses (Governor, Legislature, Judiciary)	No	No	
Idle facilities and idle capacity	No	No	Except as necessary to meet fluctuations in workload, or now idle due to changes in program requirements. This exception provided only for a reasonable amount of time (e.g. one year)
Insurance and indemnification	Yes, mostly	Yes	
Interest	No, generally	No	A-87 allows financing costs non-construction, reconstruction, acquisition after 1980, and assets used in support of federal awards
Lobbying	No	No	
Maintenance, operations, and repairs	Yes	Yes	Unless prohibited by law
Materials and supplies	Yes	Yes	
Memberships, subscriptions and professional activities	Yes	Yes	If necessary for business at hand
Motor pools	Yes	Yes	
Pre-award costs	Yes	No	Only to the extent allowable if incurred after date of award and only with approval of awarding agency
Professional service costs	Yes	?	If supported by documented evidence
Proposal costs	Yes	No	
Publication and printing costs	Yes	Yes	
Rearrangements and alterations	Yes	Yes	
Re-conversion costs	Yes	No	
Rental costs	Yes, with some limits	Yes	
Taxes	Yes	Yes	Except for self-assessed taxes that disproportionately affect Federal programs
Training	Yes	Yes	When related to specific duties
Travel costs	Yes	Yes	As necessary
Under-recovery of costs under federal agreements	No	No	

## APPENDIX C Chart of Allowable Costs: Federal Office of Management and Budget (OMB) Circular A-21

**Purpose:** To identify allowable and unallowable costs under A-21 for analysis for potential adjustment to agency indirect cost rates under A-21 if agencies use those in developing costs for Competitive Contracting.

A-87 Cost Item	Allowable Under A-87?	Adjust in WA State Model?	Comments
Advertising and Public Relations Cost	Yes, with limitations	Yes	Recruitment, procurement of goods, disposal of scrap and surplus
Alcoholic Beverages	No	No	
Alumni Activities	No	No	
Bad Debts	No	No	
Civil Defense Costs	Limited	No	Protection of life and property against enemy attack, no capital expenditures
Commencement and Convocation Costs	No	No	
Communication Costs	Yes	Yes	
Compensation for Personal Services	Yes	Yes	Salaries and wages, fringe benefits
Contingency Provisions	No	No	
Deans of Faculty and Graduate Schools	Yes	Yes	
Defense and Prosecution of Criminal, Civil Proceedings, Claims, Patent Infringements	Limited	No	
Depreciation and Use Allowance	Yes	Yes	
Donations and Contributions	No	No	
Employee Morale, Health and Welfare	Yes	Yes	
Entertainment Costs	No	No	
Equipment and Other Capital Expenditures	Yes	Yes	Except general-purpose buildings, land, equipment. Capital expenditures unallowable as F&A costs.
Executive Lobbying Costs	No	No	
Fines and Penalties	No	No	
Goods and Services for Personal Use	No	No	

A-87 Cost Item	Allowable Under A-87?	Adjust in WA State Model?	Comments
Housing and Personal Living Expenses	No	No	Interest for assets used in support of sponsored agreements
Insurance and Indemnification	Yes	Yes	
Interest, Fund Raising, Investment Management Costs	Limited	Yes, interest	
Labor Relations Costs	Yes	Yes	
Lobbying	No	No	
Losses on Other Sponsored Agreements, Contracts	No	No	
Maintenance and Repair Costs	Yes	Yes	
Material Costs	Yes	Yes	
Membership, Subscriptions, and Professional Activity Costs	Yes	Yes, if business related	
Patent Costs	Yes	Yes	
Plant Security Costs	Yes	Yes	Except civic or community memberships and country club or other social club memberships
Pre-agreement Costs	No	No	
Professional Services Costs	Yes	Yes	
Profits and Losses on Disposition on Plant Equipment	Limited	Yes	
Proposal Costs	Yes	Yes	
Rearrangement and Alteration Costs	Yes	Yes	
Re-conversion Costs	Yes	Yes	
Recruiting Costs	Yes	Yes	
Rental Costs of Buildings and Equipment	Yes	Yes	
Royalties and Other Costs for Use of Patents	Yes	Yes	
Sabbatical Leave Costs	Yes	No	If required by sponsored agreement
Scholarship and Student Aid Costs	Limited	No	
Selling and Marketing	No	No	
Severance Pay	Yes	No	



A-87 Cost Item	Allowable Under A-87?	Adjust in WA State Model?	Comments
Specialized Service Facilities	Yes	Yes	
Student Activity Costs	No	No	
Taxes	Yes	Yes	
Transportation Costs	Yes	Yes	
Travel Costs	Yes	Yes	
Termination Costs	Limited	No	
Applicable to Sponsored Agreements			
Trustees	Yes	Yes	Travel and subsistence costs